

## Message Text

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ACTION NEA-16

INFO OCT-01 ISO-00 AID-20 CIAE-00 COME-00 EB-11 FRB-02

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FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC 2990

C O N F I D E N T I A L TEL AVIV 3675

E O 11652: GDS

TAGS: ECON, IS

SUBJECT: ANALYSIS OF NEW ANTI-INFLATIONARY PROGRAM

REF: TEL AVIV 3661

1. SUMMARY: NEW PACKAGE OF ANTI-INFLATIONARY MEASURES (SEPTTEL), ADOPTED BY GOVT ON JULY 2, OFFERS REASSURING EVIDENCE THAT NEW GOVT IS PREPARED TO FACE ITS RESPONSIBILITIES IN ECONOMIC FIELD. IF PROGRAM IS FULLY IMPLEMENTED, IT WILL HAVE SOME EFFECT IN STEMMING SERIOUS INFLATION WHICH ISRAEL HAS BEEN EXPERIENCING. IT IS NOT YET CLEAR WHETHER THESE MEASURES GO FAR ENOUGH: A NUMBER OF COMPETENT OBSERVERS HAVE EXPRESSED THEIR DOUBTS. MOREOVER, IT REMAINS UNCERTAIN WHETHER PROGRAM WILL BE IMPLEMENTED FULLY, SINCE HISTADRUT STRONGLY OPPOSES ONE OF MOST IMPORTANT MEASURES IN PACKAGE (PROPOSAL TO FREEZE PART OF COST-OF-LIVING ALLOWANCE PAYABLE JULY 1).  
END SUMMARY.

2. IN ADOPTING WITH UNEXPECTED SPEED PACKAGE OF ANTI-INFLATIONARY MEASURES,

GOVT HAS DEMONSTRATED THAT IT IS PREPARED TO DEAL WITH OUTSTANDING ECONOMIC PROBLEM. THIS PROVIDES NOTABLE CONTRAST WITH INERTIA OF PRECEDING GOVT ON ECONOMIC FRONT.

FINANCE MINISTER RABINOWITZ IS ACCORDED CREDIT FOR THESE MEASURES  
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AND IF THEY ARE SUCCESSFUL, PRIME MINISTER RABIN WILL BENEFIT ALSO.

3. HAVING SAID THIS IT IS NECESSARY TO ADD THAT COMPETENT OBSERVERS HAVE EXPRESSED DOUBT WHETHER PACKAGE GOES FAR ENOUGH. BANK OF ISRAEL GOVERNOR SANBAR EXPRESSED HIS SUPPORT WITHOUT QUALIFICATION: "ANYTHING MORE STRINGENT WOULD LEAD TO RECESSION, AND ANYTHING Milder WOULD JUST MISS THE MARK." ONE OF HIS SUBORDINANTS WHO CONTRIBUTED TO PUTTING PACKAGE TOGETHER EXPRESSED DOUBT. OTHERS EXPLAINED THAT ECONOMY IS VERY LIQUID AND THAT PACKAGE WILL NOT ABSORB SUFFICIENT AMOUNT OF MONEY IN LIGHT OF VERY LARGE COST-OF-LIVING ALLOWANCE WHICH IS PAYABLE FROM JULY 1. HOWEVER, RABINOWITZ AND SANBAR HAVE CONCLUDED THAT THIS IS ALL THE TRAFFIC WOULD BEAR AT PRESENT. ALL OBSERVERS AGREE THAT THESE MEASURES WERE REQUIRED 6 MONTHS AGO. UNDER PSYCHOLOGICAL CONDITIONS PREVAILING AT THAT TIME THIS PACKAGE AND MORE COULD HAVE BEEN IMPLEMENTED WITHOUT DIFFICULTIES WHICH IT NOW FACES. BUT 6 MONTHS AGO THEN THEN GOVT BELIEVED THAT COUNTRY WAS FACING GREATER RISK OF DEFLATION, EVEN RECESSION, RATHER THAN ACCELERATED PRICE INCREASES.

4. A KEY MEASURE IN PACKAGE IS PROPOSAL TO FREEZE HALF OF APPROXIMATE 20 PERCENT COST-OF-LIVING ALLOWANCE DUE TO BE PAID FROM JULY 1. GOVT WANTS HALF TO BE PAID DIRECTLY TO THE TREASURY, WITH VAGUE PROMISE THAT IT WILL BE RETURNED SOMETIME AFTER APRIL 1, 1975. HISTADRUT GENERAL SECRETARY MESHEL HAS ENGAGED HIS PRESTIGE IN OPPOSITION TO ANY DEFERMENT, AND ENJOYS BACKING OF HISTADRUT COUNCIL. IN PAST CONFRONTATIONS OF LIKE CHARACTER, HISTADRUT HAS USUALLY SUCCEEDED IN OBLIGING GOVT TO BACK DOWN. IF THIS HAPPENS AGAIN THIS TIME, IT WILL STRIKE BLOW AT PROSPECTS OF NEW POLICY, AND AT PRESTIGE OF GOVT.

5. INCREASE IN IMPORT SURCHARGE FROM 25 PERCENT TO 35 PERCENT IS WIDELY AND CORRECTLY PERCEIVED AS ALTERNATIVE TO DEVALUATION. GOVT AND OTHER OBSERVERS ARE CONVINCED THAT DEVALUATION NOW WOULD TRIGGER TOO LARGE AN INCREASE IN COST-OF-LIVING AT TIME WHEN THIS IS MAJOR PROBLEM. HOWEVER, INCREASED SURCHARGE WILL ITSELF CAUSE SURGE IN CONSUMER PRICE INDEX. GOVT ESTIMATES PUBLICLY 2 PERCENT INCREASE IN CPI, BUT PRESS IS FORECASTING 3 TIMES THAT AND THEY MAY BE RIGHT.

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6. OF REMAINING MEASURES IN PACKAGE, MOST SIGNIFICANT ARE PROPOSALS TO CUT BUDGETARY EXPENDITURE BY 2 BILLION POUNDS, AND INCREASE EXISTING RATES OF LIABILITY FOR COMPULSORY LOAN. HOWEVER, THESE 2 MEASURES SHARE A CHARACTERISTIC: THEY ARE INTENDED TO MAKE UP FOR DEFICIENCY IN PRESENT BUDGET. EXPENDITURE AT LEVEL OF PRESENT BUDGET WILL NOT ACTUALLY BE REDUCED; INSTEAD, IT IS EXPLAINED THAT CUTS WILL ENABLE GOVT TO AVOID SUBMITTING SUPPLEMENTARY BUDGET LATER IN YEAR. LIKEWISE,

INCREASED COMPULSORY LOAN SUBSTITUTES FOR UNSUCCESSFUL VOLUNTARY LOAN.

7. PERHAPS MOST ENCOURAGING ASPECT IS THAT BEGINNING HAS BEEN MADE. MOREOVER, BANK OF ISRAEL AND FINANCE MINISTRY HAVE DEMONSTRATED ABILITY TO WORK TOGETHER. THIS PACKAGE OF MEASURES REPRESENTS FIRST SERIOUS EFFORT TO IMPLEMENT POLICY EXPRESSED IN NATIONAL BUDGET TO REDUCE INCOMES TO LEVEL OF 1972, IN ORDER TO MAKE ROOM FOR VASTLY INCREASED DEFENSE REQUIREMENTS. NONETHELESS, WE WOULD NOT BE SURPRISED IF MORE STRINGENT MEASURES WERE REQUIRED DURING COMING MONTHS.  
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